

The Agile Enterprise Product Profitability



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Product related decisions are typically made with a limited understanding of the products' true impact on corporate performance. These decisions, steeped in historical costs, fail to consider the interdependent relationships across the value chain. Consequently, managers use assumptions to make decisions without connecting product profitability directly to the company's strategic, operational, and financial objectives.



Product Profitability Optimization

Problem/Situation

Isolated decision-making is the number one killer of product profitability. And if isolated decision-making is the disease, then limited understanding and poor “what-if” capabilities are the core symptoms. Making decisions without considering the financial ramifications the decision may have at the enterprise level is commonplace. However, this should not be surprising since organizations are built and managed using hierarchical structures. Managers are held accountable and often rewarded according to the performance of each respective functional silo.

Isolated Decision Making

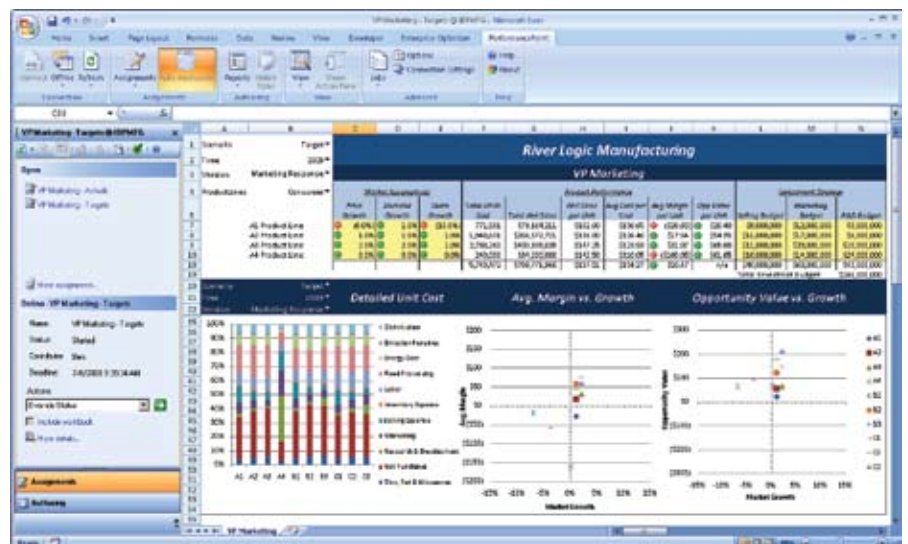
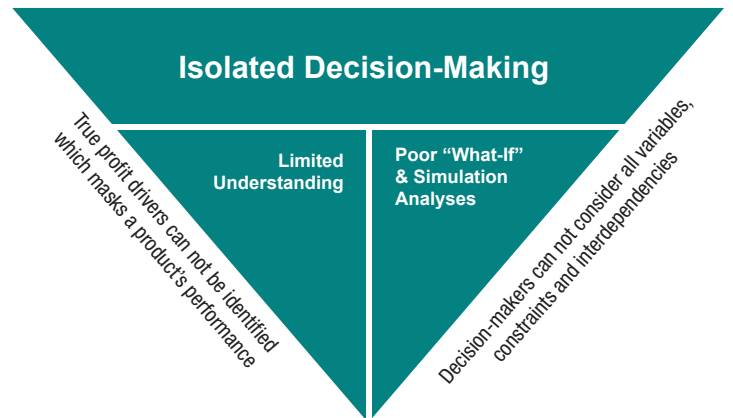
Product managers make pricing and portfolio decisions. Marketing managers allocate advertising dollars. Channel managers decide on field promotions. Demand planners build forecasts and demand plans. And inventory planners determine target fill rates and inventory requirements. The result is multiple people making multiple decisions; decisions that occur simultaneously, yet are made in isolation.

Today’s tools and systems (spreadsheets, ABC systems, demand planning systems) are made for specific analyses and therefore cannot provide a holistic decision-making platform. Without the ability to map inter-dependencies, product managers cannot align and optimize their products’ profitability based on “what’s best” for the enterprise.

Limited Understanding of the Situation

Most companies make product-related decisions with a limited understanding of their true impact on overall performance; over-focusing instead on financial metrics such as standard costs and profitability while respecting the “sacred-cows” of the sales department. While this approach occasionally yields a “good enough” approximation, more often it results in a suboptimal outcome. For example, product rationalization decisions evaluated in this way will cut those “non-sacred” products that appear to lose money. While this may seem a good decision “a-priori,” the company might end up with lower overall profitability as it reallocates production and distribution, while maintaining a smaller revenue base and perhaps a reduced ability to effectively leverage channels and customers.

Spreadsheets, ABC systems, demand planning systems, etc. cannot provide a holistic decision-making platform



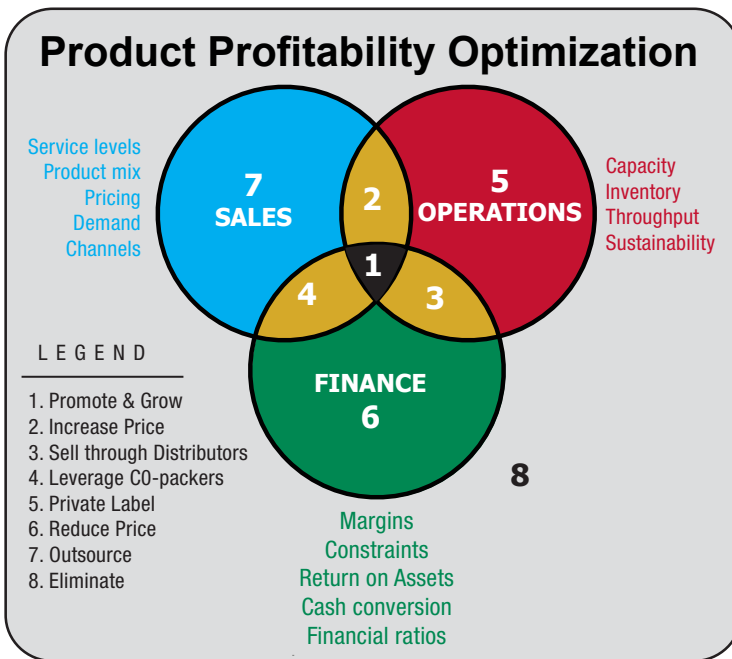
Poor “What-if” and Simulation Analyses

Current solutions do not provide the adequate support to properly evaluate decisions within the timeframe required in today’s business environment. As a result, most companies run simpler estimated analyses without simulating the impact of the decisions in a virtual environment, or properly testing the validity of their assumptions.

Additionally, scenarios must be easy to run, manage and interpret using integrated business scorecards and dashboards, as illustrated above.

River Logic's Product Profitability Optimization Solution

Built on the revolutionary COR technology and Enterprise Optimizer® EO | Server 2008, River Logic's Product Profitability Optimization solution delivers unrivalled capabilities that significantly improve the profitability of a company's product portfolio. The illustration below represents the holistic approach to product profitability. As indicated by the colored circles and text, EO enables companies to simultaneously balance decision-making, while considering the unique perspective of each department and product line.



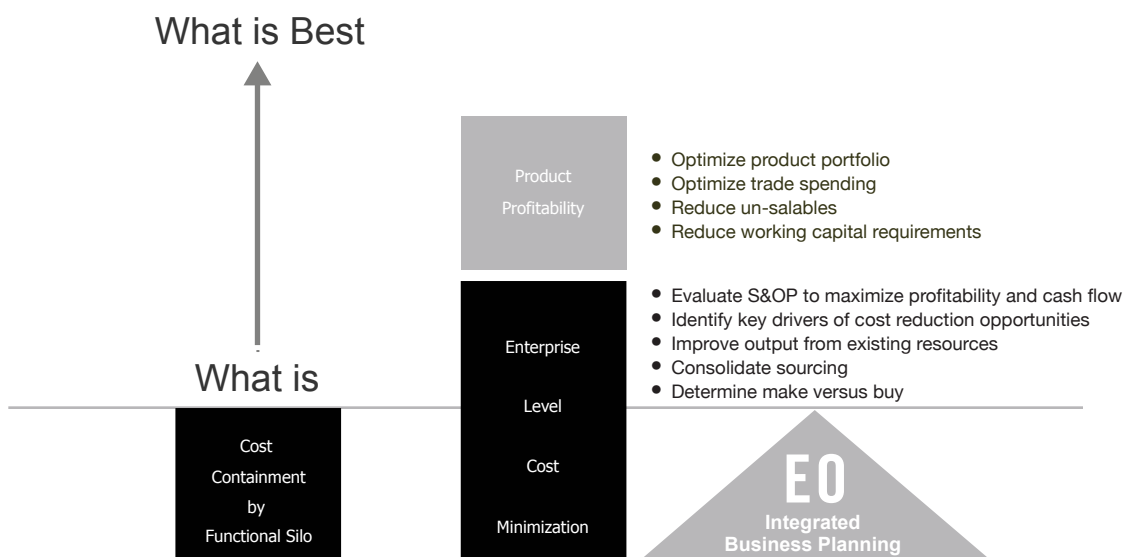
This example also includes a range of decisions resulting from an EO "solve." In the center are the "gems," the products that generate the highest return. For optimum performance, products in this category should be heavily promoted in order to expand the segment. The overlapping areas (gold) indicate a different requirement for product profitability optimization, which includes price increases, channel changes, and the adoption of co-packers.

Another critical component of EO | Server 2008 is its ability to conduct and compare "what-if" scenarios. In this example, net income was used as the objective function for determining the optimal scenario within a portfolio of alternatives. For illustrative purposes, comparisons were limited to 3 possible outcomes:

1. Net income (baseline)
2. Net income with growth in the "gems" segment
3. Baseline, plus growing the "gems", and discontinuing the under-achievers.

In other words, EO is determining net income if the company grows the gems and discontinues the underperforming products.

EO Helps Identify the Best Decisions to Maximize Profits, Cash Flow, and ROA



River Logic's Approach to Product Profitability Optimization

River Logic's **Integrated Business Planning** (IBP) system optimizes product profitability, incorporates activity-based costing, constraint-oriented process modeling, and comprehensive financial modeling to provide:

- A single model using operational, financial and KPI metrics, as well as business constraints, for integrated planning
- True product performance drivers using a system-wide view of the business, including all variables, interdependencies, suppliers, channel partners and customers
- Activity-based costing (ABC) and advanced financial modeling methodologies for calculating full costs and profits--including by-products—on a forward-looking basis
- Visibility into marginal opportunities--including all variables (e.g., input costs, resource productivity, etc.)--to yield an accurate measure of "how would the sale of an extra unit of product or SKU" impact company revenue, profitability, cash flow, capacity utilization, market share and other important metrics
- Impact of product-related decisions on Cash Flow, Balance Sheet items, and ratios such as Return on Net Assets (RONA) and Return on Invested Capital (ROIC)
- Impact of product-related decisions on sales and channel volumes, pricing, capacity utilization, inventory requirements and other operational metrics
- Optimal performance by defining the best strategy and tactical actions for each product group or family in a given scenario, using financial, operational or key performance indicator (KPI) metrics as the objective function

Companies using EO for Integrated Business Planning have increased ROIC by as much as 300%

For example, a consumer goods company used EO to improve product profitability by executing the following steps:

1. Built a model that incorporated sales, operations and finance perspectives.
2. Used the model to identify specific groups of products and specific decisions that related to that group, including:
 - a. Keep or Eliminate
 - b. Actively Promote, Neutral, Avoid Promotions
 - c. Increase Price, Decrease, Keep As Is
 - d. Make, Outsource, Private Label
3. Simulated the impact of decisions from a number of perspectives:
 - **Sales Impact**
 - Sales Quantity
 - Sales Value
 - Market Share
 - Customer Service
 - **Operations Impact**
 - Capacity Utilization
 - Inventory
 - Fill rate
 - Lead Time
 - **Impact**
 - Net Income
 - Cash Flow
 - Working Capital
4. Performed what if analysis to understand the sensitivity of the different variables, and clearly understand every product decision
5. Used the model as the communication vehicle to get all stakeholders on board and drastically reduce the change management barriers



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